B 5350-2

The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, NOVEMBER 23, 1981 VOLUME XVIII, NUMBER 47

A Squeeze At The Local Level . . .

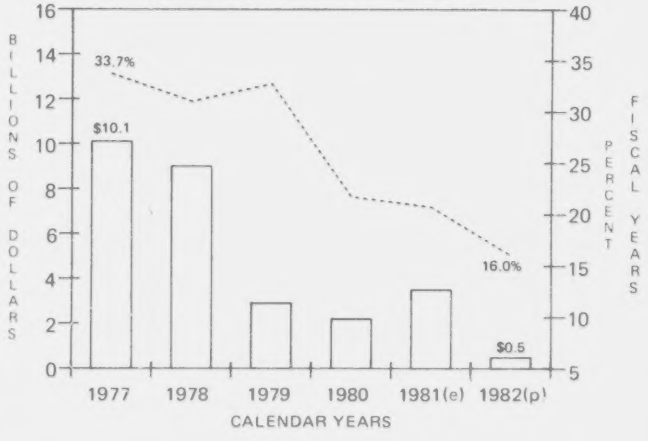
Despite the heightened concern in Washington and the financial markets over the size and timing of recently legislated Federal income tax cuts, it may be more appropriate to focus on the devastating impact which scheduled nondefense spending cuts could have at the state and local level—and, ultimately, the financial markets. These entities, in an attempt to cope with the twin challenges of reduced Federal grants and escalating costs, will probably have little choice but to either increase drastically income and property taxes as well as user fees, or scale back significantly essential and nonessential services if financial stability is to be preserved. In any event, the degree of success of these efforts will undoubtedly have a major impact upon the financial markets in coming months and, perhaps, years.

The large budget surpluses generated at the state and local level have often been cited as one reason why growing Federal budget deficits should not cause undue concern. And, indeed, state and local governments did generate a better than $110 billion cumulative budget surplus during the four years ending December, 1980 (including revenues arising from retirement and disability contributions), while, at the same time, purchasing almost $50 billion of U.S. government securities. It now seems likely, however, that the size of these surpluses is about to be trimmed, and trimmed significantly. Already the current operating portion of this surplus (which excludes social insurance funds) has nose-dived from more than $10 billion in 1977 to just about zero in the current quarter. What is more, since many of the services at the state and local level are Federally-mandated "entitlements," in such areas as health and nutrition, it appears a good bet that, in many areas, either a wide variety of taxes—whether income, property, user or excise—is about to rise, or the financial integrity of the local governing units is about to fall.

. . . Bodes Ill For The Financial Markets

As a result, local budget realities will soon be clashing head on with the wave of taxpayer revolts which has swept the country in recent years, most noticeably in California and Massachusetts. This, however, may be just a prelude to the potentially much more serious clash that could occur in the financial markets, if these trends persist. For in the absence of either scaled-back services and/or tax increases, the shrinkage of the state and local surplus will reduce not only its contribution to net national savings (about 15 per cent) but also the proportion of total Federal borrowings which it could finance (which has already been dropping sharply).

STATE & LOCAL GOVERNMENT OPERATING SURPLUS (BAR) VS. STATE & LOCAL GOV'T SAVINGS AS A % OF TOTAL FEDERAL BORROWINGS (DOT)



Washington, in turn, will thus be forced to seek additional funds from other sources, namely households and businesses. But, astonishingly, in fiscal 1981, total Federal and Federally-related borrowings were already just about equal to net private savings, with little room to spare. As a result, stepped-up Federal borrowings will simply displace further private sector credit demands, indicating once again that fiscal stimulus and monetary restraint are only compatible with a flattened private sector.

But At The Moment . . .

At the moment, however, the possibility of a sharp upturn in interest rates is far from investors' minds. Short- and long-term interest rates have moved sharply lower in recent weeks as a result of the intensifying recession, continued large shortfalls in the narrowly-defined monetary aggregates, expectations of an easing of Federal Reserve monetary policy and some abatement of commercial and

Copyright 1981
Manufacturers Hanover Trust Company
350 Park Avenue, New York, NY 10022

industrial loan demand. During the four weeks ending November 18, for example, short-term interest rates dropped from 200 to 300 basis points, led by reductions in the key Federal funds rate. Long-term interest rates also moved lower, with top-quality corporate yields falling from 70 to 125 basis points.

These declines in interest rates are probably appearing none too soon, given the rapid fall-off in the economy. Almost all indicators of economic activity are now declining, with weakness becoming more evident in a variety of industries besides autos and housing. What is more, with little evidence of any near-term strength in the economy (with the exception of defense and defense-related industries), consumer spending expected to soften and a financial squeeze of sizable proportions now affecting the corporate sector, further sharp cutbacks in employment, inventories and capital outlays are imminent. These developments, in turn, will undoubtedly lead to a further weakening in private sector credit demands and subsequent downturns in interest rates.

But the fading economy is not the only development favorably affecting the financial markets. The continuing sluggish growth of the money supply, against the backdrop of recession, augurs well for some easing of monetary policy. As of the latest four-week average, M1-B was about $9 billion below its 1981 lower growth target boundary and

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/11/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	132.172	– .489	+ 2.573
Loans to Depository Inst.	.965	– .272	– 1.102
Float	2.722	+ .270	– 1.616
Total Reserve Bank Credit	146.029	– .177	+ 2.777
Treasury Deposits with Federal Reserve Banks	3.052	– .358*	– .010
Currency Outside Banks	124.580	+ 1.353	+ 4.328
Member Bank Reserves:			
Required	39.637	– .884	– 2.049
Excess (Deficiency)	.267	+ .033	– .137
Total Reserves Held	39.904	– .851	– 2.186
Net Borrowed Reserves	.568	– .301	– .999
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	92.159	+ 1.005	+ 5.825

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	435.6	+ 2.1‡	+ 3.6‡
M2 (October '81)	1,800.3	+ 9.1	+ 8.8
M3 (October '81)	2,143.5	+ 9.5	+ 11.2
L (July '81)	2,521.3	+ 10.4	+ 11.3

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 11/20/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	9.90%	10.45%	10.46%
* Federal Agencies	11.08	11.55	12.30
* Project Notes—Taxfree (46% Taxable Equivalent)	12.04	12.22	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	11.60	11.75	12.75

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	11.38%	Dec.	11.50%
15- 29 days	11.38	Jan.	11.35
30- 59 days	11.25	Feb.	11.25
60- 89 days	11.25	Mar.	11.25
90-179 days	11.00	Apr.	11.20
180-239 days	11.00	May	11.00
240-270 days	10.50		

‡Industrial Paper—Prime			
30- 89 days	11.40%	†Federal Funds Effective Rate	12.30%
90-120 days	11.25		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'81	$ 2,957	$ 2,886	$ 2,637
Gross National Product (1972 Dollars)*	3rd Q'81	$ 1,513	$ 1,510	$ 1,472
Percent Change, Annual Rate	3rd Q'81	0.6	– 1.6	2.4
Change in Consumer Prices (all urban consumers)*	Sept '81	14.4%	9.6%	12.0%
Change in Producer Prices*	Oct '81	7.2%	2.4%	10.8%
Civilian Employment (Thousands of Persons)†	Oct '81	98,217	98,270	97,206
Unemployment as % of Civilian Labor Force†	Oct '81	8.0%	7.5%	7.6%
Personal Income*	Oct '81n	$ 2,477	$ 2,462	$ 2,234
Leading Indicators Composite Index (1967=100)†	Sept '81	130.1	133.7	134.4
Industrial Production Index (1967=100) †	Oct '81	149.5	151.8	146.6
Net Change in Consumer Installment Credit†	Sept '81	$ 2.82	$ 2.86	$ 1.06
U.S. Merchandise Trade Balance †	Sept '81	–$ 1.57	–$ 4.48	–$ 1.11
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Oct '81n	857	920	1,519
New Construction Expenditures*	Sept '81	$ 231.6	$ 232.6	$ 224.6
Total Business Inventories†	Sept '81	$ 507.2	$ 502.5	$ 471.5
Total Business Sales†	Sept '81	$ 354.2	$ 352.8	$ 327.8

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

more than $19 billion below its upper target boundary. Also, since the growth of M2 is now within its target ranges, the Fed has some leeway to take more aggressive steps to stimulate money supply growth (Economic Report—September, 1981) without deviating from its more fundamental, longer-run stance of monetary restraint. What this probably means is that it is only a matter of time before the Fed undertakes some easing measures, such as stepping up the provision of nonborrowed reserves to the banking system, guiding the Fed funds rate lower and probably trimming the discount rate, bringing it into better alignment with other market interest rates.

Short-term business credit demands, which have contributed to the high level of interest rates, are expected to weaken as the recession unfolds, and corporations undertake a significant paring of inventories, employment and capital spending plans. What is more, the Accelerated Cost Recovery System will soon be boosting cash flow, dampening credit demands at least for the next few months. Already, commercial and industrial loan demand at large weekly reporting banks has begun to weaken. Although increasing at a still robust 13.1 per cent seasonally adjusted annual rate during the three months ending November 4, it should still be noted that this rate is about one-half the rate of rise posted, at times, during the past few months. And, as short-term interest rates tumble, bond rates should fall, prompting more and more corporations

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (11/4/81)	128,180	– 1,528	+27,723
New York City (11/4/81)	31,577	– 655	+ 7,194
Commercial Paper (11/4/81)	163,709	– 921	+40,796

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/4/81)	189,868	+ 2,473	+20,339
New York City (11/4/81)	56,155	+ 889	+ 5,561

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/4/81)	460,691	+ 4,695	+41,894
New York City (11/4/81)	109,569	+ 2,174	+11,554

Financial Markets

	Friday 11/20/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.35%	– .59	– 4.65
180-Day Bills†	11.29	– .54	– 3.84
Longest Bills†	11.55	– .48	– 3.04
Recent Issues:			
12 1/8s 11/30/83 (When Issued)	12.12	NA	
15 7/8s 9/30/85	12.75	– .39	
14 1/4s 11/15/91	12.85	– .28	
14s 11/15/11	12.90	– .23	
Municipals:			
Bond Buyer—20 Bond Index* (11/19/81)	11.71%	+ .28	+ 2.21
Blue List Total ($ Million)	$ 987	+ $284	+ $ 155
30-Day Visible Supply ($ Million)	$2,217	+ $ 92	+ $ 501
Total	$3,204	+ $376	+ $ 656
Corporates:			
Moody's Aa Composite (11/19/81)	14.70%	– .28	+ 1.42
30-Day Visible Supply ($ Million)	$7,498	+ $ 45	+ $2,866
Stocks:			
Dow-Jones Averages:			
Industrials	852.93	– 2.95	– 137.00
Transportation	378.32	– 8.24	– 35.28
Utilities	111.42	+ .45	– 4.79
65 Stocks	343.89	– 2.78	– 40.26
Standard and Poor's 500 Stocks	121.71	+ .04	– 17.40
N.Y.S.E. Composite Index	70.99	+ .14	– 9.18
N.Y.S.E. Avg. Daily Vol. for Week (000's)	47,606	– 1,584	– 16,531

* 46% Taxable equivalent 21.69%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/20/81	Week Ago
Overnight	12.38%	13.00%
1 month	12.44	13.38
3 month	12.75	13.44
6 month	13.06	13.56
1 year	13.25	13.81
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.00%	14.20%
Long Term (7 to 15 yrs.)	14.70	14.85

FOREIGN EXCHANGE SPOT RATES New York Opening (11/20/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02662	37.56
Canada	.8443	1.1844
Denmark	.1385	7.2228
France	.1767	5.6600
Germany	.4456	2.2440
Italy	.0008351	1197.50
Japan	.004570	218.83
Mexico	.03867	25.86
Netherlands	.4070	2.4573
Switzerland	.5564	1.7973
U.K.	1.9080	.5241

to raise long-term debt and pay down short-term debt—dampening money market pressures even further.

. . . The Markets Are Still Strengthening

In fact, the sharp weakening of the private economy has pushed into the background investor concerns over the magnitude of Federal government borrowing requirements, and their likely impact upon the financial markets. This could be a mistake. For in the middle of all the current "good news," the outlook for Federal finances, as well as those of state and local governments, has deteriorated dramatically. It now appears that the Treasury "recession" deficit could exceed $80 billion in fiscal 1982, with associated on- and off-budget borrowing requirements reaching as high as $105 billion—a new record and significantly above the $78.3 billion enlarged Federal deficit posted in fiscal 1981.

Of course, as long as private credit demands remain flattened by recession, the record deficit will tend to limit the decline in interest rates rather than push them higher. But, as the private sector revives, their credit needs and those of government will once again collide. If short-term interest rates spike back up, the yield curve will turn negative again, rewarding those investors who stay short while penalizing those remaining long. In turn, this would destabilize the bond markets, interrupting corporate attempts to raise long-term funds. H

The Big Apple... popular symbol of New York City, headquarters of Manufacturers Hanover Trust Company. One of the world's leading banks, Manufacturers Hanover has the specialists and facilities—offices throughout metropolitan New York and upstate affiliates as well—to serve the unusual, as well as the usual, banking needs of corporations. If your business is interstate, consider this: we are a leading money center correspondent for over 3,000 U.S. banks. If your business is international, consider this: we have an overseas presence that includes over 70 facilities (branches, representative offices, subsidiaries and affiliates) in some 35 countries, and our worldwide correspondent network extends to more than 1,600 banks in 122 countries, including relationships with over 100 central banks. Whatever or wherever your banking needs, consider the source.

MANUFACTURERS HANOVER

Member FDIC